

(3) There is no obligation or implied intent to continue to sell in subsequent periods.

Tendering program means a producer's offer of a portion of its crude oil produced from a field or area for competitive bidding, regardless of whether the production is offered or sold at or near the lease or unit or away from the lease or unit.

Trading month means the period extending from the second business day before the 25th day of the second calendar month preceding the delivery month (or, if the 25th day of that month is a non-business day, the second business day before the last business day preceding the 25th day of that month) through the third business day before the 25th day of the calendar month preceding the delivery month (or, if the 25th day of that month is a non-business day, the third business day before the last business day preceding the 25th day of that month), unless the NYMEX publishes a different definition or different dates on its official Web site, *www.nymex.com*, in which case the NYMEX definition will apply.

Transportation allowance means a deduction in determining royalty value for the reasonable, actual costs of moving oil to a point of sale or delivery off the lease, unit area, or communitized area. The transportation allowance does not include gathering costs.

WTI differential means the average of the daily mean differentials for location and quality between a grade of crude oil at a market center and West Texas Intermediate (WTI) crude oil at Cushing published for each day for which price publications perform surveys for deliveries during the production month, calculated over the number of days on which those differentials are published (excluding weekends and holidays). Calculate the daily mean differentials by averaging the daily high and low differentials for the month in the selected publication. Use only the days and corresponding differentials for which such differentials are published.

(1) *Example.* Assume the production month was March 2003. Industry trade publications performed their price surveys and determined differentials during January 26 through February 25 for

oil delivered in March. The WTI differential (for example, the West Texas Sour crude at Midland, Texas, spread versus WTI) applicable to valuing oil produced in the March 2003 production month would be determined using all the business days for which differentials were published during the period January 26 through February 25 excluding weekends and holidays (22 days). To calculate the WTI differential, add together all of the daily mean differentials published for January 26 through February 25 and divide that sum by 22.

(2) [Reserved]

[65 FR 14088, Mar. 15, 2000, as amended at 69 FR 24975, May 5, 2004]

§ 206.102 How do I calculate royalty value for oil that I or my affiliate sell(s) under an arm's-length contract?

(a) The value of oil under this section is the gross proceeds accruing to the seller under the arm's-length contract, less applicable allowances determined under §§ 206.110 or 206.111. This value does not apply if you exercise an option to use a different value provided in paragraph (d)(1) or (d)(2)(i) of this section, or if one of the exceptions in paragraph (c) of this section applies. Use this paragraph (a) to value oil that:

(1) You sell under an arm's-length sales contract; or

(2) You sell or transfer to your affiliate or another person under a non-arm's-length contract and that affiliate or person, or another affiliate of either of them, then sells the oil under an arm's-length contract, unless you exercise the option provided in paragraph (d)(2)(i) of this section.

(b) If you have multiple arm's-length contracts to sell oil produced from a lease that is valued under paragraph (a) of this section, the value of the oil is the volume-weighted average of the values established under this section for each contract for the sale of oil produced from that lease.

(c) This paragraph contains exceptions to the valuation rule in paragraph (a) of this section. Apply these exceptions on an individual contract basis.

(1) In conducting reviews and audits, if MMS determines that any arm's-

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length sales contract does not reflect the total consideration actually transferred either directly or indirectly from the buyer to the seller, MMS may require that you value the oil sold under that contract either under § 206.103 or at the total consideration received.

(2) You must value the oil under § 206.103 if MMS determines that the value under paragraph (a) of this section does not reflect the reasonable value of the production due to either:

(i) Misconduct by or between the parties to the arm's-length contract; or

(ii) Breach of your duty to market the oil for the mutual benefit of yourself and the lessor.

(A) MMS will not use this provision to simply substitute its judgment of the market value of the oil for the proceeds received by the seller under an arm's-length sales contract.

(B) The fact that the price received by the seller under an arm's length contract is less than other measures of market price, such as index prices, is insufficient to establish breach of the duty to market unless MMS finds additional evidence that the seller acted unreasonably or in bad faith in the sale of oil from the lease.

(d)(1) If you enter into an arm's-length exchange agreement, or multiple sequential arm's-length exchange agreements, and following the exchange(s) you or your affiliate sell(s) the oil received in the exchange(s) under an arm's-length contract, then you may use either § 206.102(a) or § 206.103 to value your production for royalty purposes.

(i) If you use § 206.102(a), your gross proceeds are the gross proceeds under your or your affiliate's arm's-length sales contract after the exchange(s) occur(s). You must adjust your gross proceeds for any location or quality differential, or other adjustments, you received or paid under the arm's-length exchange agreement(s). If MMS determines that any arm's-length exchange agreement does not reflect reasonable location or quality differentials, MMS may require you to value the oil under § 206.103. You may not otherwise use the price or differential specified in an arm's-length exchange agreement to value your production.

(ii) When you elect under § 206.102(d)(1) to use § 206.102(a) or § 206.103, you must make the same election for all of your production from the same unit, communitization agreement, or lease (if the lease is not part of a unit or communitization agreement) sold under arm's-length contracts following arm's-length exchange agreements. You may not change your election more often than once every 2 years.

(2)(i) If you sell or transfer your oil production to your affiliate and that affiliate or another affiliate then sells the oil under an arm's-length contract, you may use either § 206.102(a) or § 206.103 to value your production for royalty purposes.

(ii) When you elect under § 206.102(d)(2)(i) to use § 206.102(a) or § 206.103, you must make the same election for all of your production from the same unit, communitization agreement, or lease (if the lease is not part of a unit or communitization agreement) that your affiliates resell at arm's length. You may not change your election more often than once every 2 years.

(e) If you value oil under paragraph (a) of this section:

(1) MMS may require you to certify that your or your affiliate's arm's-length contract provisions include all of the consideration the buyer must pay, either directly or indirectly, for the oil.

(2) You must base value on the highest price the seller can receive through legally enforceable claims under the contract.

(i) If the seller fails to take proper or timely action to receive prices or benefits it is entitled to, you must pay royalty at a value based upon that obtainable price or benefit. But you will owe no additional royalties unless or until the seller receives monies or consideration resulting from the price increase or additional benefits, if:

(A) The seller makes timely application for a price increase or benefit allowed under the contract;

(B) The purchaser refuses to comply; and

(C) The seller takes reasonable documented measures to force purchaser compliance.

(ii) Paragraph (e)(2)(i) of this section will not permit you to avoid your royalty payment obligation where a purchaser fails to pay, pays only in part, or pays late. Any contract revisions or amendments that reduce prices or benefits to which the seller is entitled must be in writing and signed by all parties to the arm's-length contract.

§ 206.103 How do I value oil that is not sold under an arm's-length contract?

This section explains how to value oil that you may not value under § 206.102 or that you elect under § 206.102(d) to value under this section. First determine whether paragraph (a), (b), or (c) of this section applies to production from your lease, or whether you may apply paragraph (d) or (e) with MMS approval.

(a) *Production from leases in California or Alaska.* Value is the average of the daily mean ANS spot prices published in any MMS-approved publication during the trading month most concurrent with the production month. (For example, if the production month is June, compute the average of the daily mean prices using the daily ANS spot prices published in the MMS-approved publication for all the business days in June.)

(1) To calculate the daily mean spot price, average the daily high and low prices for the month in the selected publication.

(2) Use only the days and corresponding spot prices for which such prices are published.

(3) You must adjust the value for applicable location and quality differentials, and you may adjust it for transportation costs, under § 206.112.

(4) After you select an MMS-approved publication, you may not select a different publication more often than once every 2 years, unless the publication you use is no longer published or MMS revokes its approval of the publication. If you are required to change publications, you must begin a new 2-year period.

(b) *Production from leases in the Rocky Mountain Region.* This paragraph provides methods and options for valuing your production under different factual situations. You must consistently

apply paragraph (b)(1), (b)(2), or (b)(3) of this section to value all of your production from the same unit, communitization agreement, or lease (if the lease or a portion of the lease is not part of a unit or communitization agreement) that you cannot value under § 206.102 or that you elect under § 206.102(d) to value under this section.

(1) If you have an MMS-approved tendering program, you must value oil produced from leases in the area the tendering program covers at the highest winning bid price for tendered volumes.

(i) The minimum requirements for MMS to approve your tendering program are:

(A) You must offer and sell at least 30 percent of your or your affiliates' production from both Federal and non-Federal leases in the area under your tendering program; and

(B) You must receive at least three bids for the tendered volumes from bidders who do not have their own tendering programs that cover some or all of the same area.

(ii) If you do not have an MMS-approved tendering program, you may elect to value your oil under either paragraph (b)(2) or (b)(3) of this section. After you select either paragraph (b)(2) or (b)(3) of this section, you may not change to the other method more often than once every 2 years, unless the method you have been using is no longer applicable and you must apply the other paragraph. If you change methods, you must begin a new 2-year period.

(2) Value is the volume-weighted average of the gross proceeds accruing to the seller under your or your affiliates' arm's-length contracts for the purchase or sale of production from the field or area during the production month.

(i) The total volume purchased or sold under those contracts must exceed 50 percent of your and your affiliates' production from both Federal and non-Federal leases in the same field or area during that month.

(ii) Before calculating the volume-weighted average, you must normalize the quality of the oil in your or your affiliates' arm's-length purchases or